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In the Supreme Court of the United States
October Term 1987

Shell Oil Company, Appellant

v.

The Iowa Department of Revenue, Appellee

On Appeal from the Supreme Court of Iowa

Brief for Department of Revenue State of Florida as Amicus Curiae in Support of Appellee

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Table of Contents

Interest of Amicus 1

Summary of Argument. 3

Argument 6

The Preapportionment Tax Base . . . 6
Gross Income. 7
Transfers Between Divisions 12
Burden of Proof 15
Purpose of OCSLA and Its Effect . . 19
State Apportionment 21
Consummated Sales-Iowa. 22
Consummated Sales-Florida 26
Shell's Asserted Separate Accounting 31
Shell's Hybrid Separate Accounting Method. 33
1. Gross Receipts 35
2. Attribution of Expenses. . 38
3. Unitary Business Concept . 39
Shell's Misapprehended Conclusion . 39
Other Shell Misapplications 44

Conclusion 48

Table of Authorities

Cases:

Butler Bros. v. McColgan, 315 U.S. 501 (1942) 32

City of Malden v. Flynn, 61 N.E. 2nd 107 (Mass. 1945) 20

Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159 (1983). 16, 39, 45

First Federal Savings & Loan v. Department of Revenue, 200 Mont. 358, 654 P.2d 496, cert. denied, 462 U.S. 1144 (1983) . . . 47

First Union National Bank of Florida et al. v. Florida Department of Revenue, ___ U.S. ___ (1988). 46

Garfield Trust Co. v. Director Div. of Taxation, ___ U.S. ___ 107 S.Ct. 390 (1986) 46

Gulf Offshore Co. v. Mobil Oil Corp., 453 U.S. 473 (1981) 19

Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931). . . 32

Interstate Finance Corporation v. Wisconsin Department of Revenue, 137 N.W. 2d 38 (1965). 14

Mobil Oil Corporation v. Comm'r of Taxes of Vermont, 445 U.S. 425 (1980) 17-18

New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1934) 15

Schwinden v. Burlington Northern, 691 P.2d 1351 (Mont. 1984) 47

Shell Oil Co. v. Department of Revenue, 496 So.2d 789 (Fla. 1986), appeal pending, No. 86-1593 (U.S. filed Mar. 20, 1987) 1,2,10-11,30,31,49

Texas Company v. Cooper, 107 So.2d 676 (1958) 41,42,47

Tropicana Products, Inc. v. Department of Revenue, CA-17-1799 (12th Jud. Cir. Manatee Co., Fla., November 22, 1976) aff. Per Curiam 353 So.2d 686 (Fla. 2nd DCA, 1977) 30

United States v. Balanovski, 236 F.2d 298 (2d Cir. 1956). . . . 37

United States v. Maine, 420 U.S. 515 (1975). 19

Welch v. Helvering, 290 U.S. 111 (1933) 15

Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940). 21

Statutes:

Internal Revenue Code, 26 U.S.C.:
s. 613 11
s. 613A 11
s. 7701(1) 14
s. 7701(14) 14

Outer Continental Shelf Lands Act, 43 U.S. ss. 1331 et seq . . . 3

Public Debt Statute 31 U.S.C.:
s. 3124 45

Submerged Lands Act 43 U.S.C.:
ss. 1301-1315 45

Florida Statutes (1972):
s. 220.13(1)(b)2 28
s. 220.15(3) 28-29

Miscellaneous:

Delaney, Adler, Epstein, & Foran, GAAP Interpretation and Application, 45 (1985 ed.) 8-9

J. Hellerstein, State Taxation (1983):
338 . . . . . 6, 37-38
8.10[2]. 32
8.10[3]. 32
8.11[5]. 41
9.17 33-34

Solomon, Gross Income-Conceptual Aspects, A-30, 31 (1986) 9-10

W. Beaman, Paying Taxes to Other States, 3.18 (1963) 32

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Interest of Amicus

The Department of Revenue, State of Florida, (Florida) submits this brief pursuant to Rule 36 of the Rules of this Court. Written consent of both parties is attached.

Florida is the appellee in Shell Oil Company v. Department of Revenue, State

of Florida, Case No. 86-1593[1]. Shell has suggested that this Court consolidate Shell v. Iowa and Shell v. Florida or that Shell v. Florida be held pending a disposition in Shell v. Iowa. 86-1593 Appellee's Supp. Memo 3 & 4. Florida opposed both suggestions because of the delay and because the consolidation would permit Shell to obfuscate the single legal issue presented in Shell v. Florida. Inasmuch as the disposition of Shell v. Iowa may impact on Shell v. Florida, Florida submits this brief. Moreover, Shell in its Brief for the Appellant herein, has brought Shell v. Florida into this proceeding (Appellant's Br. 12, 44).

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[1] The case is pending this Court's decision on whether to grant jurisdiction. For convenience and clarity it will be referred to as Shell v. Florida and the case herein before this Court will be referred to as Shell v. Iowa.

Summary of Argument

With the enactment of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. 1331, et seq, Congress codified a federal enclave outside of any state boundary over which the federal government has exclusive jurisdiction and over which "State taxation laws shall not apply". This controversy involves state taxation of the income of a multijurisdictional corporation which conducts unitary business activities in the various states and on the Outer Continental Shelf (OCS) as well.

Shell herein asserts that OCSLA mandates the use of separate accounting rather than formula apportionment to determine an amount of income it perceives as attributable to its business activity of producing oil and gas on the OCS which amount is protected under the federal geographic preemption. The

particular separate accounting method urged by Shell requires that the federal income tax concept of gross income (founded on realized gross receipts arising from actual sales) be rejected and that artificially computed market "prices" at the wellhead be substituted for actual gross receipts in Shell's hybrid separate accounting method. Shell urges that an amount of "earned income" so constructed must be deducted from the preapportionment federal taxable income base used to attribute income by the apportionment method to a taxing state.

Congress has imposed a federal tax on income which is embodied in the Internal Revenue Code (IRC). In that imposition, Congress precisely defined the federal tax accounting method, the concept of gross income, the attributable expenses and finally the resultant tax

base, federal taxable income. The various states including Florida and Iowa, with varying degrees of precision, have adopted federal taxable income, together with its underlying concepts as the starting point in determining each respective state's income tax base thus embracing the underlying federal determinations of gross income, attributable expenses and net income.

Moreover, federal determinations are also used by Florida and Iowa in determining the sales (gross receipts) fraction used to divide the single multijurisdictional federal taxable income base by apportionment. Both states use apportionment rather than separate accounting as the preferred method of dividing that income. In computing the sales fraction states attribute federally recognized gross receipts from actual consummated sales on

a destination basis.[2] Under Shell's hybrid method of separate accounting, gross receipts are attributed to the situs of production on an origin basis.

Shell asserts that the states bear the burden of establishing an "exception" within OCSLA to permit determination of a state tax base determined by federal taxable income. Florida asserts that the burden rests with Shell to etablish that the Congress mandated Shell's hybrid separate accounting method which mandate the states deny exist.

Argument

The Preapportionment Tax Base

As Shell concedes, both Florida and

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2 The use of the destination rule for attributing the receipts from sales of goods is a sine qua non, if the claim of the market States to a share of the tax base is to receive meaningful recognition. J. Hellerstein, State Taxation, 338, (1983).

Iowa adopt federal taxable income as the precise starting point in computing the preapportionment income tax base.[3] Congress precisely defined the federal tax accounting method, the concepts of gross income, the attributable expenses and the resultant tax base, all of which are prerequisites in determining federal taxable income. Among these underlying federal concepts is the concept of gross income.

Gross Income

Under generally accepted accounting principles and, federal and state income tax law, for purposes of establishing gross income used to determine the initial tax base, a consummated sale is generally recognized as a condition precedent to the realization and

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3 Both states by separate statutes make state adjustments to this preapportionment tax base. These adjustments are not relevant here.

recognition of gross income. There is no provision in OCSLA or its legislative history which mandates the contrary or any deviation from this federal standard.

Under generally accepted accounting principles (GAAP), income is normally not considered as existing before it is fully realized.

> Realization. The process of converting noncash resources and rights into money or, more precisely, the sale of an asset for cash or claims to cash ....
>
> ...the earnings process occurs throughout the various stages of production, sales and final delivery of the product. However, the difficulty in measuring the precise rate at which this earnings process is taking place has lead accountants to conclude that income should normally be recognized only when it is fully realized. Realization generally implies that the enterprise producing the item has completed all of its obligations relating to the product and that collection of the resulting receivable is assured beyond reasonable doubt.

Delaney, Adler, Epstein, and Foran, GAAP-Interpretation and Application, pp. 44, 45 (1985 ed.)

The identical realization concept is contained in federal income tax law.

> Section 61(a) incorporates a realization requirement in the definition of gross income. The section refers to "income from whatever source derived," "Gross income derived from business," and "Gains derived from dealings in property." To be taxed, gains must be realized, that is, sufficiently fixed and definite to be treated as gross income. Realization generally connotes a sale of an asset for cash or its exchange for other property. As a result of the realization requirement, the income tax taxes transactions.
>
> ****

In Helvering v. Horst, [3] decided shortly after Helvering v. Brunn, the Supreme Court amplified its definition of the realization requirement as the taxable event that occurs "when the last step is taken by which [the taxpayer] obtains the fruition of economic gain which has already accrued to him." The Court also explicitly characterized the realization requirement as one "founded on administrative convenience."

Solomon, Gross Income-Conceptual Aspects, p. A-30, 31 (1986).

Thus, no gross income is realized prior to the consummation of an actual sale. The concept of "earned income" attributable to the activity of production does not exist either under GAAP or under the Internal Revenue Code (IRC) as production must occur before an actual sale can be consummated, hence no gross income then exists.

The Supreme Court of Florida stated as follows:

> In the case at bar, this realization occurred at the time of sale. Clearly, no realization of income occurred at the wellhead, despite Shell's aassignment of an artificial wellhead price to the oil, because Shell received no actual economic gain from any "sale, exchange, or other disposition of property" at that point. s. 220.02(4)(a). Rather, realization occurred at the time Shell sold the oil in the states because only at that time did Shell derive any actual economic gain.

Shell Oil Co. v. Dept. of Revenue, 496, So.2d 789, 791 (Fla. 1986) (86-1593 J.S. App. 1-1).

Where no sale has occurred, no gross income is realized or recognized and the costs of production are merely assigned as the value of property held in inventory. This is true of motor vehicles produced in Japan and Germany, of diamonds extracted in Africa and of oil extracted in the Middle East or within a given U.S. jurisdiction.

The value of extracted petroleum products measured at the wellhead based upon artificial "prices" is used merely as a lesser included mathematical computation specifically for the limited purpose of determining the allowable depletion deduction authorized by sections 613 and 613A of the IRC and is not used to determine federal gross income.

"Earned income" attributable to production is non-existent income under these concepts. Shell construes the OCSLA to authorize the recognition of such non-existent by inference. Had Congress intended such a radical departure from established federal income tax concepts and generally accepted accounting principles, it would have so provided clearly and unequivocally.

Transfers Between Divisions

Mere internal transfers of crude oil between Shell's production division and Shell's marketing division are non-events in determining gross income for federal tax accounting purposes, regardless of assignment of artificial "prices" to such transfers for internal purposes or for determining amounts due lessors under oil leases.

As the United States has noted:

> Florida has conceded, as it must, that Shell's sales of OCS oil to independent third parties, if completed on the OCS itself, are immune from state income taxation. See J.S. App. 1-8. It might be argued from this premise that a corporation's sales of OCS oil to a related corporation, if completed on the OCS itself, would likewise be immune from state income taxation, provided that the sales comported with the norm of unrelated parties dealing with each other at arm's length. If that is so, Shell might contend that a different result should not obtain merely because the transfer occurs (as here) between divisions of a unitary corporation rather than between subsidiaries of a parent corporation. It is of course well established under the federal tax laws that, "while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not." Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 149 (1974).

86-1593 U.S. Br. 16.

Moreover, only separate legal entities are recognized as taxpayers in

the IRC as shown by the following definitions in ss. 7701(14) and (1) of the IRC:

> (14)TAXPAYER-The term "taxpayer" means any person subject to any internal revenue tax.
>
> (1)PERSON-The term "person" shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation.

Thus the IRC recognizes only legal entities and not divisions of a single corporation. No contrary recognition is visible in OSCLA. To bifurcate a corporation would be repugnant to these federal provisions. Moreover, for income tax purposes states are bound to respect the separateness and wholeness of each entity[4]. It is well established that the

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[4] For an exposition of similar state application, See Intersate Finance Corporation v. Wisconsin Department of Taxation, 137 N.W.2d 38, 44 (1965).

entity concept is essential to the protection provided by the Due Process and Equal Protection Clauses in the taxation of income.

Burden of Proof

Shell's argument conclusively presumes that OCSLA prohibits the inclusion of Shell's federal taxable income in its entirety in the preapportionment income tax base. (Appellant's Br. 16, 21).

When claiming an erosion of the initial tax base, the burden rests with the taxpayer to point to an applicable statute and demonstrate he comes within its terms. New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934); and Tax Court Rule 142. The burden of proof is intertwined with the presumption that the tax administrator's determination of a deficiency in tax is prima facie correct. Welch v. Helvering, 290 U.S.

111, 115 (1933). This Court has squarely placed the burden of proof on the taxpayer which conducts a unitary business and claims immunity from a tax. Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 175 (1983).

The burden of proof rests with Shell. In order to sustain its argument, Shell must establish either (1) the existence of a total immunity which transcends all geographic boundaries or (2) that the apportionment method used by the state to attribute income to that state is so unreasonable that an increment of total federal taxable income clearly sitused on the OCS was actually taxed by that state. Shell has failed to carry its burden to establish either.

It is well settled that apportioned state income taxes have afforded proper geographic attribution of a portion of federal taxable income to the

apportioning state.

Exclusion of an increment of income from the preapportionment tax base was addressed by this Court in Mobil Oil Corporation v. Commissioner of Taxes of Vermont, 445 U.S. 425 (1980).

> ... [The] appellant's principal objective was to achieve the subtraction of the asserted nonapportionable income from the preapportionment tax base; .... p. 432.

Therein, this Court ruled:

> It has long been established that the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation. p. 436.
>
> The argument that the source of the income precludes its taxability runs contrary to precedent. In the past, apportionability often has been challenged by the contention that income earned in one State may not be taxed in another if the source of the income may be ascertained by separate geographical accounting. The Court has rejected that contention so long as the intrastate and

extrastate activities formed part of a single unitary business. See Butler Bros. v. McColgan, 315 US 501, 506-508, 86 L Ed 991, 62 S Ct 701 (1942); Ford Motor Co. v. Beauchamp, 308 US 331, 336, 84 L Ed 304, 60 S.Ct. 237 (1939) cf Moorman Mfg. Co. v. Bair, 437 U.S., at 272, 57 L.Ed.2d 197, 98 S.Ct. 2340. In the circumstances, the Court has noted that separate accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from functional integration, centralization of management, and economies of scale. Butler Bros. v. McColgan, 315 US, at 508-509, 86 L Ed 991, 62 S Ct 701. Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable "source". Although separate geographical accounting may be useful for internal auditing, for purposes of state taxation it is not constitutionally required. p. 438.

Thus, applying this Court's constitutional criteria, the taxing state may refuse to exclude an increment of unitary income from the preapportionment

tax base and may reject separate accounting. Inasmuch as Shell's "OCS income" is concededly unitary, no constitutional hurdle exists in dividing total income by apportionment.

Purpose of OCSLA and Its Effect

This Court has at least twice noted the purpose of OCSLA:

> [T]he purpose of the OCSLA was to assert the exclusive jurisdiction and control of the Federal Government of the United States over the seabed and subsoil of the outer Continental Shelf and to provide for the development of its vast mineral resources.

Gulf Offshore Co. v. Mobil Oil Corp., 453 U.S. 473, 479, n.7 (1981). The OCSLA was intended to provide "for the orderly development of offshore resources." United States v. Maine, 420 U.S. 515, 527. Florida respectfully submits that this construction of purpose does not require total immunity of all values created upon the OCS. The statutory purpose to regulate does not require

total immunity. This power to control, restrict or limit depends upon the nature of the subject matter and the governing statute. Where the purpose of a statute is to mandate exclusive federal jurisdiction over a specific geographic area to regulate the orderly development of that area, the statute does not require absolute prohibition of authority exercised in respect of subsequent business activities (sales consummated) without that specific geographic area. Compare City of Malden v. Flynn, 61 NE 2d 107 (Mass. 1945). Total immunity cannot arise by inference where the defined purpose of the statute can be accomplished without existence of the asserted total immunity.

Shell cites a number of decisions which address a statutory grant of total immunity. These are distinguishable in that totality of immunity was required to achieve the defined purpose and the

total immunity granted was expressly stated in the governing statute, which circumstances are absent in OCSLA.

State Apportionment

This Court, in its decisions which judged the viability of a given state apportionment formula used to determine that jurisdiction's share of the federal taxable income of a multijurisdictional taxpayer has addressed solely the question of whether the resultant state tax base is fairly attributable to business activities within that jurisdiction or that "the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state".[5] Thus, this Court has focused only on the construction of the instate result.

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[5] Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940).

Florida suggests that an examination of the "instate" result of any other jurisdiction which contributes to the denominator of an apportionment fraction, while not previously deemed controlling, may be expositive.

Consummated Sales - Iowa

The following hypothetical example illustrates the assignment effected by Iowa's apportionment method:

Sales consummated in:	Federal Gross Receipts
Iowa	100,000
Nebraska	100,000
Texas	200,000
Oklahoma	100,000
OCS	200,000
All other states	300,000
Total Sales (Gross Receipts)	1,000,000

Assignment within Iowa

$\frac{100,000}{1,000,000}$ = 10% of federal taxable income[6]

Iowa uses sales (federal gross receipts) to apportion federal taxable income. The

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6 modified by state adjustments.

formula is sales (federal gross receipts) in Iowa divided by sales everywhere. The situs of a sale is based on destination. Almost all of the 45 states apportion income using sales (federal gross receipts) as part of the apportionment factor to determine the situs of a sale based on destination. In the above example, the total sales (federal gross receipts) of 1,000,000 of which 100,000 were destined within Iowa results in a 10% factor used by Iowa to determine the portion of federal taxable income assigned within that state. However, this does not fully explain the effect of the denominator.

The denominator includes both sales having destinations within Iowa and sales having destinations without Iowa. Using the above examples, 90% of the total sales apportioned are assigned without Iowa. While there is no purpose (for

Iowa tax administration) to separately detail each specific "other jurisdiction" to which each portion of these "other sales" are assigned, an analysis of the 90% reciprocal is shown as follows:

Effect of Denominator

Jurisdiction	Federal Gross Receipts	Assignment Percentage
Nebraska	100,000 =	10%
Texas	200,000 =	20%
Oklahoma	100,000 =	10%
OCS	200,000 =	20%
All other states	300,000 =	30%
Assignment without Iowa		90%
Plus Assignment within Iowa		10%
Total assignment by denominator		100%

From the foregoing, 90% of the total consummated sales are assigned without Iowa, on a destination basis. It is fairly easy to compute that portion of those sales assigned to a given jurisdiction other than Iowa using the example above. For example, the $200,000 of sales which were consummated by delivery on the OCS are constructively

assigned without Iowa because of the sales destination on the OCS. The clear effect of the denominator used by Iowa is to assign to the OCS that portion of federal taxable income which is attributable to sales consummated on the OCS. Thus, by the denominator effect, Iowa constructively recognizes the exclusive federal jurisdiction over the OCS.

To demonstrate the resultant tax base attributed to any jurisdiction which contributes gross receipts to the denominator in this hypothetical example, assume the federal taxable income computation is as follows:

Net Income

Total sales (Gross Receipts)	$1,000,000
Less: Costs and Expenses[7]	900,000
Federal Taxable Income	$ 100,000

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[7] Costs and expenses are those deductible in determining taxable income under the I.R.C.

Assignment to Iowa by apportionment is computed as 10% of $100,000 or $10,000. Assignment of a portion of federal taxable income to the OCS by the denominator effect is computed as 20% of $100,000 or $20,000. From the perspective of this hypothetical example, it is clear that income fairly attributable to business activities on the OCS has been determined consistent with the concept of exclusive federal jurisdiction.

Consummated Sales - Florida

Shell attempts to distinguish between the Iowa accommodation in respect of the income attributable to Shell's activities on the OCS and that conceded by Florida (Appellant's Br. 11, 12). This distinction is without a difference since only the method differs. The portion of federal taxable income which is thus deemed attributable to the OCS is

precisely the same.

Expressed in terms of the hypothetical example, supra, with "Florida" being substituted for Iowa, the calculation is as follows:

OCS sales (20%)	$200,000
Assigned "Costs and Expenses":	
$900,000	
x 20%	180,000
Portion of federal taxable income deemed attributed to OCS	$ 20,000

Florida first identifies the precise amount of sales which are consummated by delivery on the OCS. Then a separate apportionment using the ratio of OCS sales to total sales "everywhere" is applied to the total "costs and expenses" "everywhere". The applicable federal "costs and expenses" are attributed to the OCS by this process and are then deducted from total OCS sales to determine the portion of federal taxable income which is considered by Florida to have been derived from the OCS.

This attribution process, using the single sales fraction as the apportionment factor, is directly mandated by specific Florida statutory provisions.

Section 220.13(1)(b)2, Florida Statutes (1972) (86-1593 Mot. to Dism. or Aff. App. 1, 1-4), provided a subtraction from the preapportionment tax base of the amount of federal taxable income attributable to "sales outside the United States". Thus, the preapportionment tax base required adjustment by a subtraction as a matter of state law.

To construct the amount of the above "foreign source" subtraction, Florida uses a single sales fraction as its apportionment factor. Section 220.15(3), Florida Statutes (1972)[8], defines

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8 The term "everywhere" in part IV of chapter 214, which is used in the computation of apportionment factor denominators, shall mean "in all states of the United States, the District of Columbia, or any political subdivision of the foregoing"; and

"everywhere" for determination of the denominator as "all states of the United States, District of Columbia, or any political subdivision of the foregoing"[9]. In recognition of the OCS as an exclusive federal jurisdiction, Florida applies the definition of "everywhere" as restricted to geographic areas within the three mile limit. Thus the portion of federal taxable income attributable to the OCS is effectively treated as "foreign sourced" and is eliminated <u>before</u> Florida apportions the

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9 The above two statutory provisions remained unaltered from their enactment in 1972 until 1983, notwithstanding the citation to the contrary in the dissenting opinion of the Florida Supreme Court.

remainder.[10]

While Florida uses a hybrid method to exclude the portion of federal taxable income attributable to the OCS from the preapportionment tax base and Iowa uses straightforward apportionment of total federal taxable income in a single computation under its statutory provisions, the result in both states is identical, in concept and in fact, and existence of an exclusive federal enclave is accommodated.

The sole distinction between Shell v. Iowa and Shell v. Florida is factual. Shell failed to establish in the record

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10 Confirmation of Florida method as applied is contained in Tropicana Products, Inc. v. Dept. of Revenue, Case No. CA-17-1799 (12th Jud. Cir. Manatee Co., Fla. November 22, 1976) aff. Per Curiam 353 So.2d 686 (Fla. 2nd DCA, 1977) (86-1593 Appellee's Supp. Br. App. 1, 1a), albeit that the Court, in recognition of the laws of mathematics, simply applied the sales ratio directly to federal taxable income.

in Shell v. Florida that Shell consummated any sales by delivery on the OCS and hence no subtraction was allowed. 86-1593 United States Br. 3.

Shell's Asserted Separate Accounting

Shell attempts to impeach Iowa's apportionment method by use of a hybrid separate accounting method. Moreover, Shell asserts that the legislative history of OCSLA alone impeaches the use of apportionment which assertion Florida denies. Florida asserts that generally separate accounting cannot impeach the apportionment method and further that Shell's hybrid separate accounting method incorporates additional weaknesses which compound the inherent weakness of the fundamental separate accounting method itself. Apportionment is the method of choice used by almost all taxing states to divide income among jurisdictions. The alternative of the separate accounting method is the exception which

is rarely and only in special circumstances applied by states generally. In addressing Butler Bros. v. McColgan, 315 U.S. 501 (1942), (also cited with favor by this Court in Mobil, supra 18), "(this) holding must be read as a conclusion that separate accounting is inherently incapable of impeaching an apportionment formula." W. Beaman, Paying Taxes to Other States s. 3.18 (1963) While this statement might be viewed as an overly broad conclusion in cases of gross distortion, Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1931), it highlights the comparative weaknesses of the separate accounting method. A more definitive analysis of the weaknesses of separate accounting and its lack of ability to impeach apportionment is contained at J. Hellerstein, State Taxation, 8.10[2] and 8.10[3], (1983).

Shell's Hybrid Separate Accounting Method

Under both an apportionment or a separate accounting method it is necessary that a profit and loss statement consisting of gross income, attributable expenses, and net income must be contemplated. Those states which apportion federal taxable income as explained above use federally determined gross receipts as the measure of gross income.

While the concept of "realization" is a concept underlying determination of gross income, that concept is rationally related to construction of the sales fraction used by states for apportionment purposes.

> The terminology varies; [Uniform Division of Income for Tax Purposes Act] UDITPA and some non-UDITPA state statutes use the term "sales factor", and other states use the term "gross sales" ....
>
> The inept term "sales factor" may have been adopted because the three factor formula had its origin in, and was designed for,

> mercantile and manufacturing companies. Other States use the more appropriate term "receipts" to cover the factor.
>
> The receipts factor is usually coterminus with the apportionable receipts.

J. Hellerstein, State Taxation, 9.17 (1983).

Thus, the sales factor (gross receipts) for apportionment purposes is equated with the same receipts which comprise "gross income". Logic alone demands that a concept underlying one is similarly applicable to support the other, absent a clear statutory expression to the contrary. Common construction for both income determination affords complete symmetry and thereby minimizes distortion in result.

Generally as to attributable expenses states accept the Congressionally designed attribution rules contained in the I.R.C. and by

apportionment give them geographic situs. Most frequently the two step process above is constructively achieved with mathematical perfection by applying the apportionment factor directly to federal taxable income in a single calculation.

For a full exposition of Shell's hybrid separate accounting method, Florida addresses each of the two steps in the fundamental process of division separately as follows:

1. Gross Receipts

Shell computes its gross income (receipts) by multiplying the number of units produced times the market value at the wellhead thus using a valuation not derived from actual federal gross income (receipts) determined in respect of subsequent specific sales. Shell admits that it cannot match units of production with its actual sales of the units sold.

(Appellant's Br. 8). Shell attempts to correlate its concept of gross income to federal gross income by subjectively concluding that all considered units of production ultimately and precisely become components wholly within that federal determination and are uniformly and geographically a ratable part of any included federal gross receipt, this despite Shell's admission of its inability to trace.

Generally business activities of production precede those of sales. Where production occurs in a taxable period which precedes the period of sale, the same block of general gross receipts is not addressed and Shell's method does not accommodate this timing difference.

Moreover, under state apportionment, the assignment of gross receipts for purposes of the sales fraction is made based on the situs of the sale and not

the situs of production. This is wholly consistent with federal concepts.[11] Under Shell's hybrid separate accounting method for oil production on the OCS the gross income (receipts) would be sitused at the place of production rather than

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[11] The case of a foreign entity provides insight as to assigning geographic situs to income for tax purposes. A foreign entity is subject to federal jurisdiction based on situs of the business activity of consummation of the sale.

> (4) Under 199(a)(6) and (e) of the 1939 Code, a nonresident alien engaged in business here derives income from the sale of personal property in the country in which [the goods are] sold.

United States v. Balanovski, 236 F.2d 298, 304 (2d Cir 1956). Thus, under the IRC the consummation of a sale provides a situs for geographic assignment.

States use sales similarly in whole or in part to assign increments of income.

> The gross receipts or sales factor, as it has developed with the general use of the sales destination test, is

the place of sale. Since the place of production usually corresponds with the place of the preponderance of the property and payroll, this shift of the gross income (receipts) to the situs of production is a redundancy of any property or payroll factor. Shell's shift of gross receipts to the OCS thereby denies the existence of any contribution to value attributable to the market place via a sales fraction.

2. Attribution of Expenses

An inherent weakness of separate accounting is a determination of fair attribution of expenses. Not only is

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> designed to give weight in the apportionment to the States in which the taxpayer markets its goods.
>
> * * *
>
> The sales destination rule finds support both in fiscal policy and in the ease and convenience of compliance and administration.

J. Hellerstein, State Taxation, 336 (1983).

this inherent weakness present in Shell's hybrid separate accounting method but also Shell has not clearly defined the principles it uses in segregating related expenses. In sharp contrast, state apportionment embraces the attribution rules of the I.R.C. Moreover, the weaknesses of Shell's concept of gross income as stated above are similarly apparent in any attribution of expenses.

3. Unitary Business Concept

While conceding the unitary nature of its business operations, Shell's attempt at separate accounting is inimical to the fundamental principles which underly the unitary business concept. Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 181 (1983).

Shell's Misapprehended Conclusion

Shell erroneously concludes that Louisiana was at the time of enactment of

OCSLA using apportionment to determine the instate income tax base of all multijurisdictional oil producers without exception. Actually, Louisiana then (as now) used two alternative methods to determine instate income of multijurisdictional oil producers, depending on whether the oil producer had an instate refinery. For oil producers with instate refineries (as is the case with Shell), apportionment was used to assign respective portions of the entire federal taxable income of the taxpayer. The existence of the tremendous amounts of refinery payroll and property instate which is reflected in Louisiana's three-factor formula substantially advantaged Louisiana revenues.

However, unquestionably the great preponderance of oil producers operating wells within Louisiana lacked instate refineries. Under the tax administrator's application as manifested

in The Texas Company v. Cooper, 107 So.2d 676 (1958), which addresses the tax years 1950, 1951 and 1952, oil producers which lacked instate refineries were required to determine the Louisiana portion of considered net income by a separate accounting method which embraced the use of artificial posted (market) prices at the wellhead. As to this latter group of group of oil producers, Louisiana again advantaged its revenues by separate accounting.[12]

Florida respectfully submits that Senator Long's comments were founded on his complete understanding of the Louisiana tax scheme, and were unquestionably aimed at extending full state tax jurisdiction to include the

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12 See criticism of Texas Company v. Cooper in J. Hellerstein, State Taxation, 8.11[5], (1983).

OCS. Applying OCSLA's conceded preemption to the Louisiana administrative practice manifested in Texas Company, Louisiana revenues were disadvantaged by assignment of income to wellheads located on the OCS rather than by sales which occurred on the mainland.

To the extent that the Congressional rejection of Senator Long's urgings may be construed as a rejection of a state tax method, the method rejected must be the Louisiana separate accounting method which was using artificial posted (market) prices at the wellhead as now Shell asserts before this Court.

The OCSLA does not dictate the tax accounting method required to accomplish recognition by the states of the existence or deference to the exclusive federal enclave. Rather, the apportionment process is clearly to be preferred over Shell's hybrid separate

accounting method to achieve OCSLA's purposes.

To the extent that apportionment is deemed state tax law, it is not visiting state taxation upon the OCS but is used by the taxing states to avoid state intrusion on the OCS.

Moreover, as Shell concedes, "to fill the substantial gaps" in coverage of federal law, OCSLA borrows "applicable and not inconsistent" laws of the adjacent states as surrogate federal law. "Gulf Offshore, 453 U.S. at 480 ....", (Appellant's Br. 4).

Application of apportionment is not inconsistent with the purpose of treating the OCS as an exclusive federal enclave. It is merely the means used by apportioning states to fairly achieve the required carve-out of the increments of federal taxable income deemed realized on the OCS.

Both Iowa and Florida, in laying their respective state income taxes on Shell were exquisitely aware of and respected the existence of an exclusive federal jurisdiction. States recognized that the constitutional standards used to limit assignment of values geographically were derived from decisions of this Court in defining constitutional parameters. These standards must have been visible to and considered by the Congress in the enactment of OCSLA and were deemed adequate to effect the purpose of OCSLA in limiting state jurisdiction geographically.

Other Shell Misapplications

Shell extolls the non-controverted power of the Congress to preempt certain state taxation without delineating the precise measure of the exercise of that power. The state position is that the tax method used here apportions income to

jurisdictions in which the business activities occur . The parameters of the various states are those conceded by the Congress to be within state jurisdiction in the Submerged Lands Act, 43 U.S.C. s. 1301-1315.

This Court has distinguished an income tax from a property tax.[13] Shell fails to do likewise in citing a number of decisions which address the Federal Public Debt Statute, 31 U.S.C. s. 3124, and its grant of total immunity from property taxation. Shell fails to identify the existence of the exception contained therein whereby states are permitted to levy a franchise or another non-property tax measured by net income on corporations. The decisions Shell cites are merely examples of imperfection

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13 Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 188 (1983).

in the respective states' attempt to either fit within that statutory exception or circumvent application of the statute. Shell does not cite the plethora of decisions arising over more than a century culminating in two very recent decisions of this Court[14] in which states were successful in laying a tax within the exception. Moreover, in addressing the 1959 amendments, this Court concluded that Congress had thereby codified this Court's previously enunciated constitutional standards. Shell deems a parallel conclusion in respect of OCSLA as superfluous. (Appellant's Br. 42)

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14 Garfield Trust Co. v. Director Div. of Taxation, __ U.S. __; 107 S.Ct. 390 (1986), dismissing for want of a substantial federal question, 508 A.2d 1104 (N.J. 1986). First Union Natinal Bank of Florida, et al. v. Florida Department of Revenue __ U.S. __ (1988), dismissing for want of a substantial federal question. Department of Revenue, etc. et al. v. First Union National Bank of Florida, etc., et al., 513 So.2d 114 (Fla. 1987).

Furthermore, Shell cites First Federal Savings & Loan v. Dept. of Revenue, 200 Mont. 358, 654 P.2d 496, cert denied, 462 U.S. 1144 (1983), in which the Supreme Court of Montana struck down the Montana tax as violative of the Federal Public Debt Statute, but Shell fails to note that the Supreme Court of Montana flatly reversed its position in Schwinden V. Burlington Nothern, 691 P.2d 1351 (Mont. 1984). Shell's failure to notify this Court of Schwinden v. Burlington and Texas Company v. Cooper, can only cause confusion. Similarly, Shell's failure to identify the tax, the taxable event, and the precise extent of any other proscription in its citations of cases and statutes, particularly where that identification is not rationally related to the geographic limitation of state jurisdiction here, renders the citations non sequitors.

Finally, Shell urges that, as a minimum, OCSLA prohibits state taxation of "... Income Earned From Sales to Third Parties on the Shelf ..." (Appellant's Br. 44). However, Shell admits that Florida conceded it would do so as to sales consummated on the OCS and the denominator effect of the Iowa aportionment factor demonstrates that Iowa does likewise. Hence, Shell's assertion addresses a non-issue.

Conclusion

The United States declared that it has no substantial interest in this controversy. (86-1593 U.S. Br. 16) Moreover, the United States considers the respective Supreme Court decisions of both Iowa (U.S. Br. 6) and Florida (86-1593 U.S. Br. 6) correct and in no manner conflict with the provisions of OCSLA. For these reasons and those contained in this brief, Florida respectfully urges

this Court to affirm. Moreover, Florida urges this Court to dismiss Shell v. Florida.

Respectfully submitted,

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